

UT 97-1

Tax Type: USE TAX

Issue: Machinery and Equipment Exemption - Manufacturing
Separately Stating Tax - Separately Contracting For
Service Occupation/Use Tax - Post 1/1/90

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	Case No.
)	Reg. No.
v.)	NTL
)	
TAXPAYER,)	Administrative Law Judge
Taxpayer)	Mary Gilhooly Japlon

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Alan Osheff, on behalf of the Illinois Department of Revenue; Schain, Firsell & Burney, Ltd., by Brian L. Wolfberg, on behalf of TAXPAYER.

SYNOPSIS:

The above-captioned matter comes on for disposition pursuant to the taxpayer's timely protest of Notice of Tax Liability ("NTL") No. XXXXX issued by the Department of Revenue (hereinafter "Department") on December 27, 1994 for Retailers' Occupation Tax and Use Tax. At issue is the question of whether the purchases of caustic soda by TAXPAYER (hereinafter "TAXPAYER" or "taxpayer") are subject to Use Tax, or exempt as manufacturing and assembling machinery and equipment pursuant to section 3-5(18) of the Use Tax Act (35 ILCS 105/3-5(18)).

The taxpayer waived its request for a hearing. This cause is being decided based upon a Stipulation of Facts submitted by the parties, along with the parties' pleadings filed in support of their respective positions. Following the review of the record, it is recommended that this matter be resolved in favor of the Department of Revenue.

FINDINGS OF FACT:

1. TAXPAYER is a Delaware corporation with its principal place of business in St. Louis, Missouri. The taxpayer has a manufacturing facility in Sauget, Illinois, and is duly licensed and qualified to transact business in Illinois. (Stip. par. 1).

2. The Department audited the taxpayer for the period of July 1990 through June 1993, and issued NTL XXXXX for said period in the amount of \$1,195,005, which is at issue herein. (Stip., par. 2).

3. Part of the liability at issue concerns the Department's assessment of Use Tax on TAXPAYER's purchases of caustic soda used at its manufacturing plant in Illinois, based upon the taxpayer's purchase price of the caustic soda. (Stip., par. 3).

4. Based upon a sample audit, the Department assessed Illinois Retailers' Occupation Tax and Use Tax for the taxable period in the amount of \$501,415, excluding penalty and interest, on the taxpayer's purchases of caustic soda. (Stip., par. 4).

5. The Taxpayer, a manufacturer of chemical products, produces a product for sale known as chlorinated cyanurate, or more technically known as trichloro-s-triazinetriene. This product is sold in powdered form, and it is used as a chlorinator for swimming pools. (Stip., par. 5; Aff. pars. 2, 3).

6. In order to make the finished product trichloro-s-triazinetriene, chlorine is added to a compound known as sodium cyanurate. (Stip. par. 6; Aff. par. 4).

7. Sodium cyanurate is produced by adding caustic soda to cyanuric acid. The addition of caustic soda to the cyanuric acid causes the cyanuric acid to change into a different chemical compound (sodium cyanurate) that will allow chlorine to crystallize when added to form the final product, trichloro-s-triazinetriene. Cyanuric acid alone will not allow chlorine to crystallize. (Stip., par. 7; Aff. par. 5).

8. Caustic soda causes cyanuric acid to have a different chemical form with a different name (sodium cyanurate) and a different use (ability to allow

chlorine to crystallize when added) than it had before the addition of caustic soda. (Stip. par. 8; Aff. par. 6).

9. The Department has issued ruling letters to third parties other than the taxpayer providing for exemption for chemicals as manufacturing machinery and equipment under 35 **ILCS** 105/3-50 of the Use Tax Act. (Stip., par. 9; Exh. No. 1).

10. The Department has issued ruling letters to third parties other than the taxpayer providing for exemption for manufacturing machinery and equipment with a single use under 35 **ILCS** 105/3-50 of the Use Tax Act. (Stip. par. 10; Exh. No. 2).

CONCLUSIONS OF LAW:

The Notice of Tax Liability heretofore issued by the Department constitutes *prima facie* proof of tax liability under the assessment in question. (35 **ILCS** 120/4, incorporated into the Use Tax Act via section 12 thereof). The taxpayer seeks an exemption from tax pursuant to section 3-5(18) of the Use Tax Act, which is more fully outlined in section 3-50 thereof. It is settled case law that when considering exemptions from tax, the burden is on the taxpayer to prove clearly and conclusively its entitlement thereto. Statutes which exempt property or entities from taxation must be strictly construed in favor of taxation and against exemption. (Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455 (2nd Dist. 1995)). The general issue, therefore, is whether the taxpayer qualifies for the manufacturing and assembling machinery and equipment exemption. Stated more specifically, the question is whether the caustic soda purchased by the taxpayer constitutes "machinery" or "equipment" utilized in the "manufacturing process" of chemical products; i.e., chlorinated cyanurate.

The exemption relied upon by the taxpayer is set forth as follows in section 3-5(18) of the Use Tax Act:

(18) Manufacturing and assembling machinery and equipment used primarily in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease, whether that sale or lease is made directly by the manufacturer or some other person, whether the materials used in the process are owned by the manufacturer or some other person, or whether that sale or lease is made apart from or as an incident to the seller's engaging in the service occupation of producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser. (35 **ILCS** 105/3-5(18)).

Section 3-50 of the Use Tax Act defines the terms "manufacturing process" and "equipment" as follows:

(1) "Manufacturing process" means the production of an article of tangible personal property, whether the article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by a procedure commonly regarded as manufacturing, processing, fabricating, or refining that changes some existing material into a material with a different form, use, or name. In relation to a recognized integrated business composed of a series of operations that collectively constitute manufacturing, or individually manufacturing operations, the manufacturing process commences with the first operation or stage of production in the series and does not end until the completion of the final product in the last operation or stage of production in the series....(35 **ILCS** 105/3-50(1)).

(4) "Equipment" includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; ... any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment parts of machinery, such as tools, dies, jigs, fixtures, patterns, and molds; and any parts that require periodic replacement in the course of normal operation; but does not include hand tools. (35 **ILCS** 105/3-50(4)).

The taxpayer contends that caustic soda changes an existing material, cyanuric acid, into a different material, sodium cyanurate, with a different use; i.e., the ability to react with chlorine. Cyanuric acid will not react with chlorine without the addition of caustic soda. Furthermore, the addition of caustic soda to cyanuric acid causes cyanuric acid to change to a material with a different name; i.e., sodium cyanurate. Thus, the taxpayer asserts that caustic soda is equipment used in the "manufacturing process" of a chemical because the caustic soda causes the manufacturing process to continue from one stage of production (cyanuric acid) to another (sodium cyanurate).

The taxpayer's argument that caustic soda is "equipment" pursuant to the Use Tax Act is premised upon its assertion that "[e]quipment is an independent device ... essential to an integrated manufacturing process ...". (Emphasis

added). (35 ILCS 105/3-50(4)). The taxpayer argues that caustic soda is certainly essential to the manufacturing process because without it, chlorinated cyanurate cannot be produced. Furthermore, the caustic soda is equivalent to a "device" pursuant to dictionary definitions of the word. Specifically, according to Webster's Third New International Dictionary, a "device" is "something formulated by design...". Webster's Third Edition International Dictionary defines "device" as "... all the things used in a given work or useful in effecting a given end." Applying these dictionary definitions to the facts herein, the taxpayer claims that caustic soda qualifies as a "device".

The Department states in its Memorandum of Law that it does not dispute that the process described by the taxpayer qualifies as manufacturing and that equipment involved in the process is exempt. However, the Department does not agree that a single-use chemical, such as caustic soda, qualifies as machinery or equipment. Furthermore, although the statute considers "equipment" to incorporate devices or tools, the Department maintains that the dictionary definitions set forth by the taxpayer in attempting to argue its position are overly broad. According to the Department, if the legislature had intended for chemicals to qualify for the exemption, it could have included language to that effect in the statute.

As additional support for its position, the taxpayer asserts that several private letter rulings provide that chemicals, and even a single time use item, can qualify for the exemption at issue. The Department points out, however, private letter rulings are binding only between the Department and the party that requested the ruling. Furthermore, the facts set forth in the letter rulings can be distinguished from the facts in the instant case.

The statute and corresponding regulation dealing with this issue contemplates that there may in fact be types of tangible personal property which are used in manufacturing, but which do not qualify for the exemption. Clearly, caustic soda cannot be considered "machinery". The statute and regulation (86 Ill. Admin. Code, Ch. I, sec. 130.330 (c)(2)) define machinery as "... major

mechanical machines or major components of such machines contributing to a manufacturing or assembling process."

The regulation pertaining to the definition of "equipment" provides, *inter alia*, that equipment includes,

"... any subunit or assembly comprising a component of any machinery or auxiliary, adjunct, or attachment, parts of machinery, such as tools, dies, jigs, fixtures, patterns and molds, and any parts which require periodic replacement in the course of normal operation. The exemption does not include hand tools, supplies (such as rags, sweeping or cleaning compounds), coolants, lubricants, adhesives, or solvents, items of personal apparel ..., coal, fuel oil, electricity, natural gas, artificial gas, steam, refrigerants or water." (Ill. Admin. Code, Ch. I, sec. 130.330 (c)(3)).

It appears that the one-time use of the caustic soda characterizes it as a consumable supply, as opposed to a fixed asset that is depreciated over time. Taxpayer in its response brief argues that parts which require periodic replacement, as well as tools, dies, jigs, fixtures, patterns and molds tend not be capital assets, yet are affirmatively stated to constitute equipment. However, the taxpayer fails to comprehend that the reference to repair or replacement parts refers to parts of machinery which already qualify for the exemption. The amendment of the statute in 1984 enlarged the scope of the exemption in this respect. The reference to tools, dies, jigs, fixtures, patterns and molds alludes to parts of qualified machinery. In the instant case, the caustic soda is not part of any larger piece of machinery, nor does it constitute a repair or replacement part. As stated in Van's Material Co. v. Dept. of Revenue, 131 Ill.2d 196, 215 (1989), "... the purpose of the original statute was to 'give business a tax exemption on capital investment'." (81st Ill. Gen. Assem., House Proceedings, June 29, 1979 at 239 (statements of Representative Ewing)).

While it is true that the legislature intended that certain tax benefits be provided to businesses involved in the process of manufacturing tangible personal property (see: Vans, *supra*, at 216), the language of the statute

surely does not convey that a one-time use chemical be accorded an exemption. Private Letter Ruling 95-0207 (cited by the taxpayer) specifically provides that the catalysts found to be exempt are used repeatedly until normal wear and tear require them to be replaced. Furthermore, they are treated as assets for accounting purposes, and amortized over their useful lives in accordance with generally accepted accounting principles. In the instant case, it is stipulated that the caustic soda has a one-time use. Additionally, in regard to the catalysts at issue in the above-cited letter ruling, they do not become part of the manufactured product. The record is void of any evidence as to whether the caustic soda ultimately becomes part of the manufactured product. Since the purpose of the original statute was to give business a tax exemption on capital investment, it would appear that that purpose must be kept in mind when determining whether a particular item of tangible personal property qualifies for the exemption.

The other private letter rulings cited by the taxpayer can be distinguished likewise. PLR 87-0714 provides that molds used one time can qualify for the exemption. However, the statute specifically includes molds as being exempt. PLR 85-0315 exempts acid used in the manufacturing of molds. However, the acid requires periodic replacement, and therefore, has more than a one-time use. Additionally, molds are specifically exempt, and the acid is used in the machining of molds in the same manner as a milling machine. Certainly, caustic soda is used in the manufacture of cyanuric acid. However, unlike molds, the cyanuric acid has a limited one-time use and is not a substitute for any machine.

As stated previously, case law is abundant and clear that in determining whether property is to be included within the scope of an exemption, all debatable questions are to be resolved, and all facts are to be construed in favor of taxation. Every presumption is against the intention of the state to exempt property from taxation. (Follett's Illinois Book & Supply Store, Inc. v. Isaacs, 27 Ill.2d 600 (1963)). The exemption claimant must prove clearly and

conclusively its entitlement to the exemption sought. (Wyndemere Retirement Community, supra). In the instant case, the statutory language at issue does not lend itself to include a one-time use chemical such as caustic soda as machinery or equipment exempt from taxation. Therefore, it must be presumed that the State intended to tax caustic soda. The taxpayer/claimant herein has not proved clearly and conclusively its entitlement to the exemption. Therefore, the assessment at issue must be affirmed.

RECOMMENDATION:

Based upon the foregoing, it is my determination that NTL No. XXXXX must stand as issued.

Administrative Law Judge